ATCO GAS

2008-2009 General Rate Application
Income Tax Module

(November 12, 2009)

ALBERTA UTILITIES COMMISSION
Decision 2009-214: ATCO Gas
2008-2009 General Rate Application Phase I
Income Tax Module
Application No. 1553052
Proceeding ID. 11

November 12, 2009

Published by
Alberta Utilities Commission
Fifth Avenue Place, 4th Floor, 425 - 1 Street SW
Calgary, Alberta
T2P 3L8

Telephone: (403) 592-8845
Fax: (403) 592-4406

Web site: www.auc.ab.ca

Contents

List of Tables

ALBERTA UTILITIES COMMISSION
Calgary Alberta

ATCO GAS **Decision 2009-214**
2008-2009 GENERAL RATE APPLICATION **Application No. 1553052**
INCOME TAX MODULE **Proceeding ID. 11**

1 INTRODUCTION

1. In Decision 2008-113, [1] the Alberta Utilities Commission (AUC or Commission) issued its findings with respect to the 2008-2009 General Rate Application (GRA) Phase I for ATCO Gas (AG or ATCO). In that decision, the Commission found that it was not in a position to determine the proper regulatory treatment for a number of tax related issues, namely: the effects of the 1999 - 2005 income tax reassessments processed by the Canada Revenue Agency (CRA) for ATCO Gas and Pipelines Ltd.(AGPL) (the Reassessments) and resulting recovery (AG Recovery), the deferral accounts proposed by interveners for income taxes and the treatment of costs that had been capitalized for accounting purposes but deducted on a current basis for income tax purposes. Further, in that decision, the Commission considered that the manner in which AG had dealt with certain matters relating to the recovery of income taxes in periods prior to the test years could have implications with respect to fundamental regulatory principles. Consequently, the Commission deferred its consideration of these unresolved issues and set a specific income tax process (Module) to deal with them. This Decision pertains to matters addressed in the Module.

2. In making the above findings in Decision 2008-113, the Commission invited parties to make further submissions on the regulatory treatment that can and should be accorded to the cost increases/reductions occasioned by income tax reassessments, deferral accounts for income taxes, and, AG's treatment of costs that it capitalizes for regulatory purposes but deducts as a current expense in the year incurred for income tax purposes.[2] In making these submissions parties were also invited to address all factors they considered relevant to the treatment of the unresolved income tax issues. More particularly, the Commission requested comment on the following nine points:

> 1. Are issues, facts or circumstances raised in the records of EUB[3] applications and decisions (from 1999 to 2006)[4] on the subject of the income tax deductions which were the subject of the AGPL income tax reassessment, relevant to the Commission's consideration of the issues raised by the reassessment in this proceeding and if so, how are they relevant?

---

1 Decision 2008-113 - ATCO Gas, 2008-2009 General Rate Application Phase I (Released: November 13, 2008).
2 Costs that have been capitalized for accounting purposes but deducted for income tax purpose on a current basis have also been referred to as running expense or as *Rainbow*- type expenses from *Rainbow Pipe Line Co. v. Canada*, [1999] T.C.J. No. 604; *Rainbow Pipe Line v. Canada*, [2002] F.C.J. No. 920 (Appeal Dismissed) (*Rainbow).*
3 Alberta Energy and Utilities Board, predecessor to the Commission.
4 For example Decision 2001-96 - ATCO Gas South GRA 2001-2002 and Decision 2003-072 - ATCO Gas 2003-2005 GRA.

2. Should the Commission consider past EUB decisions relating to AG (North or South) regarding these deductions in making its determination in this proceeding? If the EUB did not address the issue of the potential for these deductions, is it fair for the Commission to do so now?
3. If the EUB had given a direction to AG to pursue these income tax deductions, would parties consider that such a direction would have amounted to micro-management of the utility?
4. Considering that a company in a competitive environment would be incented by market forces to seek all eligible deductions to make itself more competitive, does it fall to the regulator, when no competitive market forces are present, to step into the shoes of a competitive market and direct the utility to apply for specific tax deductions?
5. Did AG have an obligation to notify the EUB of its intention to apply for reassessment to the CRA given the timing of that application?
6. Is it open to the Commission to consider whether it was imprudent of AG to not take these deductions when they were first identified? If so, based on the prudency test enunciated in the DGA Decision and upheld by the Alberta Court of Appeal, did AG act imprudently in not seeking the tax deductions when they were first identified?
7. Is the treatment of these income tax deductions by the other ATCO regulated utilities relevant and, if so, how? Also, given the use of deferral accounts for income taxes by AE and AP, for consistency should AG be directed to establish same?
8. Is the Commission limited in the range of options available to it by application of legal principles dealing with retrospectivity or retroactive rate making, or any other legal principles? If so, please describe the limitations with reference to applicable case law and how the case law supports the position being taken.
9. Is AG's current treatment of *Rainbow*[5] type expenses sufficient for the test years?[6]

3. The Commission initially set the following process to deal with the Module:

Argument for all parties:	December 4, 2008
Reply Argument:	December 14, 2008.

4. In setting this process, the Commission considered that AG's forecasts of income tax expense for 2008 and 2009 (as amended by the Commission's Direction in Section 12.1 of Decision 2008-113) would be used as placeholders until the Commission made its findings with respect to the Module.

5. By letter dated November 21, 2008 AG noted conflicts in its regulatory schedule and proposed that the dates for argument and reply be moved to March 17, 2009 and April 7, 2009. The Office of the Utilities Consumer Advocate (UCA) responded to AG's proposal noting that the reasons provided by AG did not justify a four-month extension. Given the complexity of the issues, UCA recommended argument and reply dates of February 20, 2009 and March 3, 2009.

6. The Commission agreed with UCA and revised the dates for argument and reply for the Module to February 20, 2009 and March 3, 2009 respectively.

[5] As described in *Rainbow Pipe Line Co. v. Canada*, [1999] T.C.J. No. 604; *Rainbow Pipe Line v. Canada*, [2002] F.C.J. No. 920 (Appeal Dismissed).
[6] Decision 2008-113, pages 101-102.

7. By letter dated January 12, 2009 AG indicated that it intended to file expert evidence with regard to the income tax issues raised by the Commission, and requested the Commission to set a procedural deadline of January 30, 2009 for all parties to file evidence.

8. UCA and the Consumer Group (CG) recommended that a more formal process that included information requests, intervener evidence, rebuttal evidence, simultaneous argument and reply, and the possibility of an oral hearing should be considered to address the issues in the Module. AG supported the recommendation for a process that allowed for these unresolved income tax issues to be fully clarified and understood.

9. Consequently, the Commission established the following schedule to deal with the Module:

Filing of Additional Evidence by AG	January 30, 2009
Information Requests to AG on additional evidence	February 13, 2009
Information Responses by AG	February 27, 2009
Additional Evidence from Interveners	March 20, 2009
Information Requests to Interveners	April 3, 2009
Information Responses by Interveners	April 17, 2009
Oral Hearing	TBD
Argument from all parties	TBD
Reply Argument all parties	TBD

10. By letter dated May 25, 2009, the Commission advised that it had received unanimous agreement from interveners that an oral hearing was not required. Therefore, the Commission set dates of June 9, 2009 and June 23, 2009, respectively, for simultaneous argument and reply submissions.

11. By letter dated July 8, 2009, the Commission advised parties that in Decision 2009-087[7] (Proceeding ID 86) with respect to ATCO Electric Ltd. (AE), the Commission had concluded, that more information was required to determine the proper regulatory treatment of income tax issues similar to those being dealt with in this Module. As a result the Commission had sought views from parties registered for the AE proceeding on the following matters:

- Should opening rate base balances for the test years be reduced to reflect the expensing of the Additional Deductions[8] which were previously capitalized for income tax purposes? And if so, by what amount?
- If opening rate base balances are adjusted should AE be permitted to adjust its operating expense in the test years? And in prior years?
- If opening balances remain unadjusted for the test years, will customers pay higher rates than would have otherwise been required?
- Since $19.2 million of UCC[9] is no longer available for use to reduce income tax expense for customers, should AE continue to earn a return on these items which remain in rate base as capital? Please support your answer with references to legal and regulatory principles.

[7] Decision 2009-087 - ATCO Electric Ltd. 2009-2010 General Tariff Application Phase I (Released: July 2, 2009).
[8] Defined term for three additional income tax deductions for easement costs, stock handling costs, and removal and abandonment costs; and the retention by AE of the income tax refund related to these deductions for 2006, 2007 and 2008 in the amount of $6 million.
[9] Undepreciated capital cost.

- Are there any changes other than the reduction of rate base opening balances that should be considered?[10]

12. Given the similarities between the AG and AE income tax issues, the Commission considered that parties in the AG proceeding should also respond to the above noted questions, albeit in the context of the record and tax deductions at issue in the AG proceeding. The Commission considered that this additional response would enable it to issue fair and consistent rulings on the income tax issues for both AG and AE. As a result, the Commission set the dates of July 31, 2009 and August 14, 2009, respectively, for simultaneous responses and reply responses from interested parties to address these additional points.

13. The division of the Commission assigned to deal with these matters consisted of Commission Chair, Mr. Willie Grieve, Commissioners Mr. Bill Lyttle and Mr. N. Allen Maydonik Q.C. The Commission considers that August 14, 2009 was the close of record for the Module.

14. Parties that participated in the Module were The City of Calgary (Calgary), UCA, and CG.

15. In reaching the determinations contained within this Decision, the Commission has considered all relevant materials comprising the full record of this proceeding. Accordingly, references in this Decision to specific parts of the record are intended to assist the reader in understanding the Commission's reasoning relating to a particular matter and should not be taken as an indication that the Commission did not consider all relevant portions of the record with respect to that matter.

2 BACKGROUND

16. AG noted that, prior to 1998, costs that it had capitalized for rate setting and financial statement purposes were also capitalized for income tax purposes (i.e., included in undepreciated capital cost (UCC)). AG also noted that prior to the *Canderel* decision[11] this treatment of capitalized amounts was a position taken by tax authorities and supported by the Courts.[12] In 1999, pursuant to the *Canderel* decision, certain indirect costs[13] that were previously capitalized for both financial statement and income tax purposes in1997 and 1998 by the predecessor companies[14] to ATCO Gas and Pipelines Ltd. (AGPL)[15] were accepted by tax authorities as being deductible in the year incurred. Consequently, income tax recoveries for those years were received by those companies. In addition, income tax recoveries for more additionally allowed deductions of indirect costs by those companies involving the years 1994 through 1997 were also received by AGPL in 2001 and 2002.[16] AG stated that the benefits related to the current

[10] Decision 2009-087, paragraph 298.
[11] *Canderel Limited v. The Queen*, 98 DTC 6100 (SCC) (*Canderel*).
[12] Exhibit 263.02, CAL-AG IT.1.
[13] Exhibit 93.00, Application; Indirect Capital Costs were defined as costs common to various capital projects, which, due to the nature of the work performed cannot be charged to a specific project, page. 6.0-2.
[14] Predecessor companies were Northwestern Utilities Limited and Canadian Western Natural Gas Company Limited.
[15] AGPL is a taxable corporation; AG, as a division of AGPL, does not file income tax returns.
[16] Exhibit 262.02, UCA-AG-153 (b) Attachment, page 1 of 9.

deduction for income tax provision purposes of the capitalized indirect cost have been included in its applicable GRA filings effective with the 2001/2002 GRA Phase 1 for AG South.[17]

17. AG stated that, beginning in December 2005, it investigated and subsequently identified, in addition to the indirect costs capitalized certain direct costs that had been capitalized for accounting and income tax purposes but which it believed should qualify as running expenses (as those expenses were defined by the Supreme Court of Canada in the *Canderel* decision). Running expenses, although capitalized for accounting purposes, are deductible in the year incurred for income tax purposes. AG listed the following categories of the costs (additional running expenses) that it capitalized for accounting purposes but considered should qualify as being eligible for deduction in the year incurred for income tax purposes:

- Vehicle and heavy equipment operating costs,
- Non-direct labour costs,
- Stock handling costs,
- Payroll burden costs, and
- Fringe benefit costs.

18. AGPL pursued recovery of income taxes paid for the years 1999 through 2005 for the additional running expenses, which it had originally included in UCC but which it now claimed as being deductible in the year incurred. This pursuit included a real time audit made by the CRA prior to the filing of AGPL's 2005 income tax return in 2006, which found that only 4 percent of the identified costs should be allowable deductions in the year incurred. AGPL continued by filing a Notice of Objection with the Appeals Division of the CRA, which in November 2007 increased the allowable deductions to approximately 38 percent of the amounts claimed. AG summarized the findings of the Appeals Division in the following table:

Table 1. Approximate Percentage of Costs Eligible for Deduction

	Approved %
Vehicle and heavy equipment operating costs	15
Non-direct labour costs	80
Stock handling costs	100
Payroll burden costs	40
Fringe benefit costs	0

Source; Exhibit 93.00, pages. 60.3.

19. Ultimately, AG's portion of the amounts recovered through reassessments was approximately $8.6 million ($4.5 million relative to its north service territory (AGN) and $4.1 million relative to its south service territory (AGS)).[18]

20. AG originally filed its 2008/2009 GRA Phase 1 on November 2, 2007. For its income tax forecasts, AG included additional income tax deductions in the test years for additional capital costs eligible for deduction in the year incurred, net of contributions, which resulted from the CRA real time audit and subsequent ruling of the Appeals Division. AG set out its forecasts of the deductions in the following table:

[17] Ibid, pages 1 and 2 of 9.
[18] Exhibit 34.05, CCA-AG-11(t), Attachment.

Table 2. Additional Capital Costs Eligible for Deduction

	$000s		
	2007 Forecast	2008 Forecast	2009 Forecast
Additional Deductions	6,649	6,922	7,414

21. AG submitted that revenue requirement, net of reduced capital cost allowance (CCA) claims [i.e., tax deductions akin to accounting depreciation expense], was reduced by $2.3 million in 2008 and $2.4 million in 2009 as a result of the increase in these deductions.[19]

22. AG considered that the benefits obtained from the income tax recoveries for the years subject to the findings of the Appeals Division of the CRA was outside of the test years and should be for the account of AGPL's shareholders. Consequently, the UCC balance that would have been carried forward absent the deductions of the direct costs and used in the determination of its forecasts of income tax expenses was permanently reduced.[20] This amount would be unavailable for future income tax benefits that would have otherwise accrued to customers by way of higher CCA deductions from UCC.

23. AG confirmed that it had not included any deductions in respect if the additional running expenses in its 2005-2007 GRA Phase 1.[21] In commenting with respect to AG's ability to reasonably forecast any of the additional running expenses, AG's expert, Hon. Donald G. H. Bowman, Q.C., responded that:

> In my opinion it would have been both imprudent and unreasonable for ATCO to base any forecast of future taxes on the assumption that it would be successful in deducting such expenses currently until it received confirmation by the CRA. In the over forty five years in which I have been involved in tax matters, either as Crown counsel, as a tax litigator in private practice or as a judge on the TCC, there is one thing that I can state with certainty and that is that in an area as controversial as that involving the distinction for tax purposes between capital and revenue expenditures there is no certainty.[22]

Mr. Bowman also referred to the *Canderel* decision and the *Johns Manville* [23]decision as illustrations of:

> the virtual impossibility of forecasting the outcome of any dispute with the CRA involving the deductibility of expenses where the question of capital versus revenue is in issue.[24]

[19] Exhibit 143.01, AG Rebuttal Evidence, page 133.
[20] Exhibit 283.01, CG Argument, page. 19, paragraph 54; CG estimated the reduction of UCC balances to be $23.8 million.
[21] Exhibit 262.02, UCA-AG-153(d).
[22] AG Evidence re Income Tax Issues filed on January 30, 2009 - Fraser Milner Casgrain LLP, letter dated January 28, 2009, page 3.
[23] *Johns ManviIle Canada Inc.* v. *The Queen*, 85 DTC 5373 (SCC).
[24] AG Evidence re Income Tax Issues filed on January 30, 2009 - Fraser Milner Casgrain LLP, letter dated January 28, 2009, page 3.

3 SUMMARY OF VIEWS ARISING FROM AG INCOME TAX QUESTIONS

24. The views of parties in response to the Commission's nine questions from the AG 2008-2009 GRA proceeding are summarized below:

Question 1. Are issues, facts or circumstances raised in the records of EUB applications and decisions (from 1999 to 2006) on the subject of the income tax deductions which were the subject of the AGPL income tax reassessment, relevant to the Commission's consideration of the issues raised by the reassessment in this proceeding and if so, how are they relevant?

25. Calgary noted that the matter as to whether ATCO was claiming the maximum deductions available has been questioned since ATCO originally indicated the ability to deduct additional costs in keeping with the *Canderel* and *Rainbow* decisions. Calgary considered that ATCO appeared to be engaging in a pattern of practice where customers ultimately bear additional tax costs while shareholders benefit from higher earnings.

26. Calgary noted that there was no *stare decisis* doctrine applying to the Commission. In any event, the issue germane to this proceeding is that there was no saving or efficiency gain, other than the time vale of money – which is simply a timing issue. ATCO has simply moved the payment of tax further into the future.

27. UCA considered that this case was a continuation of a pattern that has cost customers and benefitted shareholders. Previous records indicated that customers have been concerned with the utility accurately forecasting the maximum income tax benefits possible and that utilities have repeatedly harmed customers by claiming additional deductions outside of the current test years.

28. CG noted the history associated with previous income tax reassessments for Northwestern Utilities Limited and Canadian Western Natural Gas (predecessors to AGN and AGS respectively). CG concluded that it was inappropriate and imprudent for AG to not ask the Commission for deferral account treatment of these items, particularly given the material nature of the changes arising from the additional tax deductions. Alternatively, and at a minimum, AG should have filed with the AUC a request for advice and direction on its proposed change in a tax method from the one previously approved in prior Decisions, including Decision 2004-047[25] in respect of AG's 2003-2004 GRA.

29. ATCO considered that past issues, facts and circumstances on the subject of income tax deductions in the records of past applications to be relevant, as they provide the framework on which ATCO governs itself and provide a precedent that utilities may rely upon. While the Commission is not bound by prior decisions, consistency and predictability are important regulatory principles. Utilities order their affairs and conduct themselves in significant measure, on the basis of what the regulator has indicated is acceptable.

30. Noting the UCA's suggestion that there has been a history of repeated offense,[26] and Calgary's position that ATCO is engaging in a pattern of practice,[27] ATCO argued that customers have been receiving benefits associated with income tax deductions related to the

[25] Decision 2004-047 - ATCO Gas 2003/2004 General Rate Application Second Compliance Filing (Application No. 1346376) (Released: June 15, 2004).
[26] Exhibit 279.02, UCA Argument, paragraph 29.
[27] Exhibit 278.01, Calgary Argument, page 2.

Canderel case for some time now. The benefits of these income tax deductions recognized by ATCO outside of test periods have been reviewed by the regulator in previous GRA's. Interested parties had every opportunity to put forward their case at the time of those reviews. ATCO noted that the regulator did not find that ATCO had committed any offense or inflicted any harm to customers. Nor was ATCO required to provide any retroactive benefit to customers.

Question 2. Should the Commission consider past EUB decisions relating to AG (North or South) regarding these deductions in making its determination in this proceeding? If the EUB did not address the issue of the potential for these deductions, is it fair for the Commission to do so now?

31. Calgary noted that this was the second time this situation has occurred and that it would be fair for the Commission to address the potential for these deductions as they impact the future income tax expense that ATCO will seek to include in rates. Adjusting the CCA pool balances will ensure that customers are no worse off as a result of the income tax reassessments.

32. UCA considered that these issues were addressed in previous rate applications, and that the history went back as far as 2001. There was a clear pattern in which the utility forecasted tax pools then sought to increase deductions outside of the test period and as such benefit shareholders at the cost of customers. The Commission must protect customers from such abuses. UCA was only requesting the Commission protect customers from future harm arising from the actions of ATCO.

33. CG considered that the Alberta Energy and Utilities Board (EUB or Board) and customers could not possibly have known about or dealt with AG's request in May, 2006, for a real time audit, the July, 2006, results of this audit or the subsequent March, 2007, appeal of the same, as AG did not alert or advise parties of these events at the time. AG should have been aware of the Board's general guidelines respecting the use of deferral accounts and should have taken steps to notify the Board and parties at the time. CG submitted that AG had a responsibility under the regulatory compact to at least advise the Board of these circumstances at that time.

34. With respect to Questions 1 and 2, CG agreed consistency and predictability were important regulatory principles, however CG submitted that the cases relied upon by AG were not applicable to the current circumstances. Specifically, these decisions dealt with, for example, cost savings arising from isolated transactions outside of a test year and where such transactions did not unduly affect or harm customers. In this case, the re-filing of prior year tax returns demonstrably and adversely impacted customers and resulted in a clear violation of the regulatory compact.

35. ATCO submitted that to address these issues now would require a restatement of previously approved revenue requirements for prior years. This would be retroactive ratemaking which the Commission is legally prohibited from doing.

Question 3. If the EUB had given a direction to AG to pursue these income tax deductions, would parties consider that such a direction would have amounted to micro-management of the utility?

36. Calgary considered that such a direction would not be micromanagement; however, Calgary thought that such a direction would not be necessary since ATCO would seek to minimize the income tax expense for the benefit of customers as it receives its return on equity after tax.

37. Calgary also argued that micro-management was not the issue, but rather this was an issue of fairness.

38. UCA noted in Decision 2008-100,[28] the Commission considered that directors and management have responsibilities to ratepayers that include capturing all efficiencies that will reduce the cost of utility service to ratepayers. As such, the Commission should not have to make such a decision. However, ATCO has chosen to act in a manner that harms customers, thus the Commission must act. Further, this was not an issue of micro-management and the amounts involved were significant.

39. CG argued that in light of the significant amounts of the additional tax deductions claimed in respect of the years 1999-2006, no reasonable party could possibly argue an EUB direction to pursue such tax deductions would amount to micro-management. In instances where a utility does not appear to be pursuing certain known opportunities or potential opportunities, it is not only reasonable for the Commission to request a utility to examine those options more closely and report on those at a later date; it is part of the Commission's legislated mandate.

40. ATCO considered that it was the role of management to manage income taxes and other operating costs. Through the use of prospective rate making, the Commission approves a revenue requirement and provides the incentive for ATCO management to efficiently manage all operating costs, including income tax expenses. Directing what ATCO should or should not deduct for income tax purposes would clearly hand the reins, in terms of the management of ATCO, to the regulator.

Question 4. Considering that a company in a competitive environment would be incented by market forces to seek all eligible deductions to make itself more competitive, does it fall to the regulator, when no competitive market forces are present, to step into the shoes of a competitive market and direct the utility to apply for specific tax deductions?

41. Calgary considered that it would have been difficult for the regulator to direct ATCO to apply for specific reductions. In a competitive market ATCO could not use flow-through income taxes, and would have had to defer the "tax saving" and customers would not be facing a future income tax liability because these amounts had been deducted for income tax purposes. Customers, or the unregulated company, or both, would have had the benefit of or shared the time value of the tax savings.

[28] Decision 2008-100 - ATCO Electric Ltd. Stand Alone Study (Released: October 21, 2008) (Proceeding ID. 18), page 6.

42. UCA noted that the role of regulation and the regulator was to be a surrogate for competition. In this regard, the Commission must ensure that the activities of the regulated utility are prudent, in the best interests of customers and result in rates which are not unjust or unreasonable. The *Stores Block*[29] decision considered:

> [T]he principal function of the Board in respect of public utilities is the determination of rates[30]
>
> and
>
> it should only exercise its discretion to act in the public interest when customers would be harmed or would face some risk of harm.[31]

43. As the Commission is also aware, the *Gas Utilities Act* authorizes the Commission to:

> … disallow or change, as it thinks reasonable, any tolls or charges that, in its opinion, are excessive, unjust or unreasonable …
>
> and
>
> … exercise a general supervision over all gas utilities ….”[32]

44. UCA considered that the utility has an obligation to reduce the cost of utility service to ratepayers. Given the harm involved in this case, this obligation is even more imperative for customers.

45. CG submitted that the tax deduction taken by AG was a timing shift which resulted in a benefit to AG shareholders at the expense of customers.

46. ATCO viewed that the challenge for the regulator was how to maintain the types of incentives that exist with market forces in a competitive environment. To a large extent, these incentives have been created through prospective regulation and the absence of deferral accounts. This environment creates the incentive for utilities to seek cost reductions through efficiencies which flow to shareholders in the short term and customers in the longer term. The additional income tax deductions were a perfect example of the incentive created and the win-win situation that results from prospective regulation with no deferral account.

Question 5. Did AG have an obligation to notify the EUB of its intention to apply for reassessment to the CRA given the timing of that application?

47. Calgary considered that AG had no legal obligation to notify the regulator; however, it had a moral obligation to give notification, particularly in light of what had transpired in 1998 and 1999 and the interest deductions under the *Rainbow* and *Canderel* criteria that arose in subsequent periods.

---

[29] *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4 (*Stores Block*).
[30] *Stores Block*, paragraph 60.
[31] *Stores Block*, paragraph 84.
[32] *Gas Utilities Act*, sections 16(c) and 22(1).

48. UCA noted that in Decision 2003-072, the Board ordered:

> The Board therefore directs ATCO, in the Refiling, to advise the Board on the process adopted to identify in the accounting records, those costs capitalized, but considered by the Company to be ordinarily deductible and being deducted for tax purposes in the year incurred. [33]

49. Given the history of "repeated offense" and the fact that ATCO was directed to develop a process to identify these costs,[34] UCA submitted that ATCO had an obligation to inform the Commission of the change. Further, the regulatory process should not be a game of "hide and seek" where the Commission and interveners have to look in the correct spot to find information. ATCO must provide complete and comprehensive information when filing its GRA's.

50. CG considered that AG had an obligation to notify the EUB of its intention to apply for reassessment to the CRA given the timing of that application. The amounts sought in the tax re-filings were material and there was a reasonable expectation the Commission and interveners would be extremely concerned to discover AG's actions would result in elimination of approximately $23.8M of future tax benefit for customers. AG was well aware of the Commission's practice respecting the use of deferral accounts, even in the absence of a GRA. AG should have advised the Board of the need for either an advice and direction meeting or a deferral account treatment following the identification in late 2005 of potential additional deductions.

51. ATCO did not view it necessary to advise the Board or Commission that it was appropriately managing its costs; nor by implication, to secure prior approval of its strategies for doing so. The requirement to notify seemed to ATCO to suggest that it should have acted as if it had a deferral account for income taxes when in fact it did not or that it should have acted as if it was being regulated based on actual results rather than on a prospective basis.

52. ATCO indicated that as part of information request UCA-AG-153(b), it provided a full and complete timeline of events leading to the deductibility of these additional amounts. The chronology provided clearly shows that ATCO as not aware of the potential for additional income tax deductions prior to the closing of the record of the 2005-2007 GRA and, therefore, did not have the opportunity to notify the Commission during the process as suggested.

Question 6. Is it open to the Commission to consider whether it was imprudent of AG to not take these deductions when they were first identified? If so, based on the prudency test enunciated in the DGA Decision and upheld by the Alberta Court of Appeal, did AG act imprudently in not seeking the tax deductions when they were first identified?

53. Calgary submitted that based upon the record of this proceeding, it was not clear when these deductions were first identified. If AG had been required to reflect the deduction in the determination of the revenue requirement prior to obtaining a ruling, or having a real time audit, it was unlikely that AG would have done so without the protection of a deferral account.

[33] Decision 2003-072 - ATCO Gas, 2003/2004 General Rate Application, Phase I (Released: October 1, 2003), page 231.
[34] Exhibit 279.02, UCA Argument, paragraph 29.

54. Calgary noted that ultimately, the tax will have to be paid when these assets are amortized and the amortization is collected in rates. It was unfair and unreasonable that ATCO's shareholders should get the benefit of the reduced taxes and leave the customers to pay the ultimate tax bill.

55. UCA stated that it had no evidence to suggest that AG acted imprudently and noted that any delay in obtaining CRA approval to the deductions in question affected only the timing of the deductions. However, it would have been helpful to interveners and the Board to have known of AG's application during the course of its 2005-2007 GRA.

56. CG considered that in the Alberta regulatory environment, when a utility is faced with a scenario where the transaction, or proposed transaction, is beyond its reasonable control and associated amounts are material, or potentially material, the Commission and its predecessors have approved the use of deferral accounts. AG was imprudent not to ask the Commission for deferral account treatment of these costs at the time it initiated a request for a real time audit on May 5, 2006.

57. ATCO considered that it was not reasonable to assume that it could or should have known that these costs were deductible. ATCO submitted that these costs were not identified as being deductible immediately following the *Canderel* decision by the other member companies of the Canadian Gas Association and were not being deducted by other utilities in Canada. ATCO was challenged to demonstrate to CRA that these costs were truly not attributed to the improvement or creation of a capital asset particularly when the costs were charged directly to capital projects for accounting purposes. In ATCO's view, it was being aggressive in pursuing these additional deductions and pushing the limits with regard to the criteria established by CRA for running expenses. ATCO noted that not all of the costs that it sought to have treated as running expenses were actually allowed once the matter was finalized.

Question 7. Is the treatment of these income tax deductions by the other ATCO regulated utilities relevant and, if so, how? Also, given the use of deferral accounts for income taxes by AE and AP, for consistency should AG be directed to establish same?

58. Calgary submitted that for consistency and fairness AG should have a deferral account for income taxes. Once one regulated entity claims a deduction, it is likely that other regulated affiliates would also claim the deductions.

59. UCA noted that the identical issue was raised in the AE 2009-2010 GTA proceeding. From a policy standpoint, the treatment of changes in income tax legislation and practice should be consistent among utilities. UCA was of the opinion that deferral accounts were not necessary to address this particular issue provided that material changes in income tax methodology were approved by the Commission either on special application or during the course of a GRA.

60. ATCO did not recommend deferral accounts be established unless they meet the criteria established by the Commission. With regard to income tax deductions, ATCO did not view that they meet the criteria for deferral account treatment. Once ATCO has a ruling from CRA, it can forecast these deductions with a reasonable amount of certainty and they are not beyond the control of ATCO. For these reasons, ATCO did not support the use of a deferral account for income tax deductions.

Question 8. Is the Commission limited in the range of options available to it by application of legal principles dealing with retrospectivity or retroactive rate making, or any other legal principles? If so, please describe the limitations with reference to applicable case law and how the case law supports the position being taken.

61. Calgary submitted that the Commission should refrain from making retroactive decisions. Retrospectivity is at the heart of deferral accounts and many other regulatory mechanisms.[35] Calgary noted that the proposed treatment for the CCA pools was no different than the treatment of CCA pools when TransAlta sold its distribution system to UtiliCorp, and the deemed CCA pools were not overturned by the courts.

62. Calgary noted that in discussing the principle of prospectivity, ATCO considered that income taxes were a "cost" similar to any other expense ATCO Gas incurs.[36] Calgary argued that income taxes are not like other costs. They are treated differently. Virtually all other costs are required by the regulator (and for accounting purposes) to be accounted for on an accrual basis. By contrast, income taxes are recorded on a flow through basis which, while not a strict cash basis, is not fully an accrual account. If ATCO was using the future income tax method of accounting for income taxes there would be no issue. The expense/cost would have been recorded, a regulatory liability would have reflected the fact that the amounts would be payable in the future, and the only benefit to ATCO's shareholders would be the time value of the accelerated tax deductions. It is only because of the dissimilarity of income tax expense that this issue has arisen and ATCO could attempt to deprive customers of the benefits of the tax deductions while still seeking to have them reimburse ATCO for the higher income tax in the future.

63. Noting section 36 of the *Gas Utilities Act*, UCA considered that the Commission must set just and reasonable rates, and protect customers from harm. Given the history, allowing ATCO to retain the gains cannot be seen to be just and reasonable.

64. Noting section 40 of the *Gas Utilities Act*, UCA was not requesting the Commission to revisit the costs of prior periods, only that the Commission prevent the harm arising from imprudent actions to impact rates in the future, and prevent ATCO from using an argument of retrospective rate making to benefit from repeated abuse of the same issue.[37]

65. UCA considered that maintaining the UCC balances at the amounts they would have been absent ATCO's actions does not offend any of the fundamental legal principles discussed by ATCO.

66. CG considered that the Commission must take into consideration its overall broad mandate to ensure the interests of both customers and shareholders are fairly balanced, in addition to any considerations respecting the application of legal principles dealing with retrospectivity or retroactive rate making. By adopting a new income tax deduction on a retroactive basis and keeping the resulting benefit for its shareholders, CG submitted there was clear evidence AG has violated the principle of "regulatory compact" and thereby caused material harm to customers. In CG's submission, the harm caused by AG must be remedied by

[35] Exhibit 278.01, Calgary Argument, page 6.
[36] Exhibit 280.01, AG Argument, paragraph 84.
[37] Exhibit 279.02, UCA Argument, paragraph 38.

either refunding the $8.6M refund it received to customers or, alternatively, reinstating the $28.3M of lost UCC as at January 1, 2007.

67. ATCO considered that the following fundamental regulatory principles were relevant in the subject proceeding and provided extensive commentary on: (a) the principle against retroactive rate-making; (b) the principle of prospectivity (whereby the utility is entitled to retain efficiency gains over the short-term); and (c) the principle of regulatory certainty. Further, each principle provided additional support for ATCO's position that the additional tax deductions for prior years should be retained, in the short-term, by ATCO shareholders and, in the long-term, by ATCO customers.

Question 9. Is AG's current treatment of Rainbow type expenses sufficient for the test years?

68. Calgary submitted that while parties have had the opportunity in this proceeding to better understand the nature of the reassessment, it may be appropriate to provide the opportunity to allow parties to re-examine the deductions taken, to ensure that those taken for period costs are consistent with the re-assessments and not just the *Rainbow* and *Canderel* decisions.

69. UCA considered that Calgary's recommendation was worthy of consideration. Further, the Commission should reiterate its direction in Decision 2003-072, namely:

> The Board therefore directs ATCO, in the Refiling, to advise the Board on the process adopted to identify in the accounting records, those costs capitalized, but considered by the Company to be ordinarily deductible and being deducted for tax purposes in the year incurred.[38]

70. UCA also recommended that all utilities must provide full and complete information in all filings. Even disclosure of ongoing issues such as this would be beneficial to the Commission.

71. CG submitted that AG should be directed to file a study of the potential capital repair projects which may be eligible for the *Rainbow-type expense*-tax treatment as part of its next GRA and demonstrate it has taken into account the Rainbow-type costs approved by the AUC and CRA for other utilities, including ATCO Electric and TransAlta Utilities, in Alberta. As part of this study, AG should provide a detailed assessment of all its major (greater than $100,000) capital repair/maintenance type costs and provide rationale as to why discounted projects do not meet even one of the four *Rainbow* tax criteria for immediate tax deduction.

72. ATCO reviewed all of its costs charged to capital for accounting purposes. That review did not identify any additional amounts over and above the well work over and abandonment costs currently deducted. Had ATCO identified amounts over and above the well work over and abandonment costs, it would have requested they be reviewed as part of the CRA real time audit. ATCO submitted that its forecast of *Rainbow* type expenditures in the test period was appropriate.

[38] Decision 2003-072 - ATCO Gas, 2003/2004 General Rate Application, Phase I (Released: October 1, 2003), page 231.

73. With respect to Calgary's recommendation, ATCO submitted that interveners had the opportunity during the GRA process to reexamine the deductions taken to ensure that those taken for period costs were consistent with the re-assessments and not just the *Rainbow* and *Canderel* decisions. This process provided interveners with a further opportunity to re-examine the deductions taken.

4 SUMMARY OF VIEWS ARISING FROM AE INCOME TAX QUESTIONS

74. The views of parties in response to the Commission's five questions from the AE 2008-2009 GTA are summarized below. The Commission notes that some parties referenced specific material from the AE proceeding in responding to the questions.

Question 1. Should opening rate base balances for the test years be reduced to reflect the expensing of the Additional Deductions which were previously capitalized for income tax purposes? And if so, by what amount?

75. CG stated that any adjustment to the regulatory treatment should be approached with caution as depreciation, return and income tax impacts would also need to be considered. Further, CG commented that there was no evidence which showed that costs related to the Additional Deductions were imprudently incurred.

76. The UCA preferred the reinstatement of the UCC balances, but alternatively supported a regulatory adjustment to the opening rate base based on the after tax difference to the UCC balance caused by the Additional Deductions, with possible consideration being given to the time value of money impact. The UCA argued these adjustments were not retroactive rate-making as only current and future rates would be affected, and that the Commission had wide discretion for determining just and reasonable rates.

77. Calgary noted that traditionally, the Commission, and its predecessors have not adjusted the carrying value of the rate base based upon the tax deductibility (or otherwise) of the assets in rate base ("net of tax method"). Calgary suggested that moving to this method on an item specific basis is not a preferable approach.

78. AG argued that no adjustment was needed. The amounts in rate base have previously been approved by the Commission or its predecessor as prudent costs. There was no evidence to suggest that any of this property was no longer required to be used, was abandoned, or that its values have been impaired. Adjusting opening rate base balances would be a confiscation of a utility asset. Further, it would be inappropriate to have the income tax treatment of costs be identical to regulatory treatment. ATCO was not aware of any attempt by regulators to align utilities' capital and depreciation practices with income tax rates and allowances. In addition, financial statements have been issued and audit opinions made on the basis that these costs have been appropriately capitalized. AG stated that the principles of retroactive rate making, prospectivity, regulatory certainty, and doing indirectly that which cannot be done directly, did not allow adjustment to the opening rate base balances for the test years. AG also stated that such an adjustment would be inconsistent with section 37(1) of the *Gas Utilities Act* to reduce the rate base to reflect the tax refunds.

Question 2. If opening rate base balances are adjusted should AE be permitted to adjust its operating expense in the test years? And in prior years?

79. CG submitted that the Additional Deductions should not be recovered as part of operating expenses either in the test year or prior period revenue requirement as this would involve changing AE's capitalization policy. CG stated that this type of recovery would also need to adjust the return, depreciation and income taxes associated with those amounts. Further, no operating expense adjustment was necessary as the assets associated with the Additional Deductions still existed and were used to provide utility service even though AE confiscated the UCC for income tax purposes.

80. The UCA submitted the utility should be allowed to recover the amount of the write-off, but only in future test periods. The UCA stated that since income tax deductions for these adjustments have already been taken, any operating expense adjustment would need to take this into consideration.

81. Calgary submitted that to now treat these amounts as an operating expense for prior years would be retroactive ratemaking. To include the amounts as an expense in the test years could harm customers since the amounts would be included in their rates but the tax deductibility of the amounts would not necessarily be assured since they were incurred in prior periods. Going forward, it is an option to treat the amounts deductible for income taxes and currently capitalized as an operating expense and reduce the rate base.

82. AG stated that there was no regulatory, legal or policy basis to deny AG's recovery of its prudently incurred investment or a fair return on those amounts on the basis of the proposed reduction of the opening rate base. Further, a reduction to opening rate base balances would not impact AG's legislated right to recover its prudently incurred costs. Any adjustment or write-off to rate base would be recorded as depreciation and amortization (not as operating expenses). Such an adjustment would be recorded in the current year and would not be a restatement to prior years' financial results.

Question 3. If opening balances remain unadjusted for the test years, will customers pay higher rates than would have otherwise been required?

83. Calgary, CG and the UCA argued that customers will pay more as the CCA deductions, which previously offset the depreciation add-back for calculating income tax expense, have been lost to customers. CG commented that the assets remained in rate base and were part of depreciation even though they were written off when calculating income taxes.

84. AG argued that customers benefited in the long term due to the Additional Deductions taken. These benefits amount to $22.6 million after taking into account reduced CCA claims. Given these benefits, it is clear customer rates will be lower than they would be had AG not taken these additional tax deductions.

Question 4. Since $19.2 million for AE of UCC is no longer available for use to reduce income tax expense for customers, should AE continue to earn a return on these items which remain in rate base as capital? Please support your answer with references to legal and regulatory principles.

85. CG stated that if the assets are used and required for providing services to customers and were prudently incurred, then the utility is entitled to earn a reasonable return on its investment.

86. The UCA commented that this would depend on whether these costs were for used and useful utility assets or whether they were operating costs. For ATCO to get the income tax ruling, it had to demonstrate these costs were not capital under the income tax rules, but this was in conflict with ATCO's capitalization policy which required a use of more than one year. The UCA expressed concern that AE recovered the income tax balance benefit twice; once in the income tax re-filings and a second time in rates.

87. In direct response to this question, Calgary considered that reducing the rate base by the amount of the $19.2 million Additional Deductions would unduly penalize AE. There are other items in rate base that have not had tax deductibility associated with them, such as the equity component of AFUDC and capitalized depreciation. These items have been treated as part of the rate base not withstanding the lack of tax deductibility of the amounts. In addition, timing and temporary differences have been incurred for many years with the assets included in rate base with no tax deductibility. Therefore on the basis of regulatory principles, Calgary submitted that there was no basis to remove amounts with no tax deductibility from rate base. Further, section 90 of the *Public Utilities Act* does not indicate that a criterion for inclusion in rate base is tax deductibility.

88. AG argued it should continue to earn a return on the capital invested to provide utility services as the assets were prudently incurred. AG is permitted under section 4(3) of the *Roles, Relationships and Responsibilities Regulation*[39] to recover its prudently incurred costs:

> 4(3) A gas distributor is entitled to recover in its tariffs the prudent costs as determined by the Commission that are incurred by the gas distributor to meet the requirements of subsection (1).

Question 5. Are there any changes other than the reduction of rate base opening balances that should be considered?

89. CG recommended as an alternative approach that the Commission direct a reduction to the depreciation add-back in the calculation of income tax expense by the amount of foregone CCA. CG also submitted that a simpler alternative would be to increase the amount of the no-cost capital by the amount of the income tax refund received by AG. Customers would receive a credit equal to the weighted average cost of capital. CG argued that an opening rate base adjustment for Additional Deductions should not be treated as a current year depreciation and amortization adjustment as proposed by AG, with it being collected from customers in the next adjustment deferral account application. Instead of recovering the adjustment over the lives of the assets for this one year adjustment, CG recommended that the Commission deem the amount to be a prior year adjustment.

[39] AR 186/2003.

90. UCA stated that AG should be required to submit all substantive changes like the Additional Deductions for approval within the context of a GTA. The UCA also recommended the review of AG's capitalization policy in a future GTA.

91. Calgary recommended that the appropriate change was to adjust the test years' opening UCC by the amount of the addition deductions.

92. AG submitted that the evidence on the record in the 2008-2009 GRA Proceeding, the subsequent Module as well as the additional evidence provided through its submission, clearly establish that there is neither an evidentiary foundation, nor a legal basis, for the Commission to order a refund, a restatement of the UCC balance or a reduction to the opening rate base balance. Moreover, there can be no other means available to accomplish the same improper purpose.

5 COMMISSION FINDINGS

93. In issuing its findings with respect to the matters raised in the Module, the Commission has considered the legal principles and legislation which must guide the Commission's review of the consequences of the Reassessments undertaken by AGPL, the deferral accounts proposed by interveners for income taxes, and the treatment of costs that had been capitalized for accounting purposes but deducted on a current basis for income tax purposes.

5.1 Legal Principles

94. As noted above in Decision 2008-113, the Commission posed the following question with respect to the income tax issue:

> 8. Is the Commission limited in the range of options available to it by application of legal principles dealing with retrospectivity or retroactive rate making, or any other legal principles? If so, please describe the limitations with reference to applicable case law and how the case law supports the position being taken.[40]

95. The Commission notes the following response from ATCO:

> 58. The following fundamental regulatory principles are relevant in the subject proceeding: (a) the principle against retroactive rate-making; (b) the principle of prospectivity (whereby the utility is entitled to retain efficiency gains over the short term); and (c) the principle of regulatory certainty.[41]

96. The Commission has reviewed the regulatory principles identified by AG and has considered the application of these principles in the context of its determination of (a) what treatment should be applied to the AG Recovery, including whether it should be returned to customers, (b) whether the Commission should adjust the UCC balance, or (c) whether there should be an adjustment to the opening rate base balance for the test years if AG is permitted to keep the refund.

[40] Decision 2008-113, page 102.
[41] Exhibit 280.01, AG Argument.

Principle Against Retroactive Ratemaking

97. The principle against retroactive ratemaking has been canvassed by the courts in a number of decisions.

98. In the Supreme Court of Canada decision of *Northwestern Utilities Limited and P.U.B. v. City of Edmonton*, [1979] 1 S.C.R. 684, the Court discussed whether future rates could recover past revenue losses. The Court stated that future rates could not be used to recover accumulated losses in the past:

> ... It is conceded of course that the Act does not prevent the Board from taking into account past experience in order to forecast more accurately future revenues and expenses of a utility. It is quite a different thing to design a future rate to recover for the utility a "loss" incurred or a revenue deficiency suffered in a period preceding the date of a current application. A crystallized or capitalized loss is, in any case, to be excluded from inclusion in the rate base and therefore may not be reflected in rates to be established for future periods. [42]

99. The Supreme Court of Canada in *Stores Block* commented on the issue of retroactive ratemaking as follows:[43]

> [71]…There is no power granted in the various statutes for the Board to execute such a refund in respect of an erroneous perception of past-overcompensation. It is well established throughout the various provinces that utilities boards do not have the authority to retroactively change rates.[44]

100. More recently, the Board in Decision 2008-023 stated:

> [If] [Westridge] did not have a labour capitalization policy in 2004/2005, it was collecting 100% of its Board-approved labour costs from customers in its operating revenue requirement. To allow [Westridge] to capitalize some of those costs in 2005/2006 would require a corresponding adjustment to the labour costs approved by the Board in Decision 2005-028 for the 2004/2005 period. To do so ***would*** require the Board to engage in retroactive ratemaking and, for that reason, the Board does not approve these capitalized amounts attributed to 2004/2005 in [Westridge's] 2005/2006 rate base.[45]

101. The Commission considers itself to be bound by the principle against retroactive ratemaking as outlined above.

Principle of Prospectivity

102. The principle of prospectivity was addressed by the Commission in Section 3 of Decision 2008-113. The Commission has also considered the following excerpt, as set out in AG's argument, cited from Canada Energy Law Services:

> …The Board's approach to utility regulation follows the principle of prospective ratemaking. Rates are established on the basis of information relating to or available at

[42] As cited in Exhibit 280.01, AG Argument, paragraph 60.
[43] Exhibit 280.01, AG Argument paragraph 63.
[44] *Stores Block*, paragraph 71.
[45] Decision 2008-023 - Westridge Utilities Inc., *General Rate Application* (Released: April 15, 2008), page 17.

> the test period and apply until such time as another rate decision is issued by the Board. The Board will not approve rates designed to recover revenue shortfalls in past years. Equally, utilities are entitled to profits which are in excess of earnings projected at the time of rate setting.
>
> Cost-of-service ratemaking does not guarantee utilities a given rate of return. Rather, they have the opportunity to earn that rate of return, which is calculated on the basis of information and assumptions that the Board considers reasonable for the test period. One reasons for the prospective approach to ratemaking is that it arguably provides an incentive for utilities to operate in an efficient manner. Once the rates are established, a utility can increase its earnings by reducing costs…[46]

103. Consistent with the principle of prospectivity and the principle against retroactive ratemaking, the Commission considers that it is incumbent on utility management to prepare forecasts using the best information available at the time. These forecasts are subject to updates during the evidentiary portion of the proceeding where material changes have occurred that impact the initial assumptions. Once the evidentiary portion of the proceeding has closed, the Commission issues its decision based on the information before it.

104. The CG submitted that the principle of prospectivity and the principle against retroactive ratemaking, which enable a utility to realize productivity gains over the test years, cannot be applied in this situation because a tax deduction is not a productivity gain. In support of this, the CG cited Decision 2008-113, wherein the Commission held:

> The Commission acknowledges that AGPL pursued the tax deductions that resulted in the reassessment but cannot agree that a company availing itself of a permitted tax deduction that it qualified for in the past but had not pursued, are attributable to a productivity gain.[47]

105. As noted in the above passage, the Commission in Decision 2008-113 arrived at its finding that there was no productivity gain in that circumstance because it found that ATCO simply availed itself of an available tax deduction.

106. It was AG's evidence that it was not aware of the potential for additional income tax deductions prior to the closing of the record of the 2005-2007 GRA and, therefore, did not have the opportunity to notify the Commission during the process as suggested. AG stated its income tax forecasts for the 2000-2007 period were prepared based on the best information it had available to it at the time.[48] The Commission considers that AG is a large, sophisticated utility with access to centralized ATCO Tax group services, for which it is allocated costs, and that it would have a high level of awareness of developments and their related income tax applicability. However, in the absence of any evidence on the record of this proceeding to the contrary, the Commission must accept AG's evidence that it was not aware of these potential deductions. The Commission notes that none of the interveners filed evidence which challenged AG on this point.

[46] Exhibit 280.01, AG Argument, paragraph 75, citing from Canada Energy Law Services (Alta. Commentary paragraph 757 & 758).
[47] Decision 2008-113, page 101.
[48] Exhibit 285.01, AG Reply Argument, paragraph 67.

Principle of Regulatory Certainty

107. The principle of regulatory certainty recognizes that there is significant benefit and strong preference for certainty and stability in the regulatory process. For public policy reasons, companies should have the ability to operate in an environment that is predictable.

108. The Board in Decision 2004-035 acknowledged this principle when it stated that its decision was rendered to be in "keeping with its past practices and to promote regulatory consistency".[49]

109. The Commission agrees with its predecessor that it is important for the public, including utilities, to be able to rely on the finality of its decisions, subject to any appeal remedies that may be available.

5.2 AG Recovery

110. The Commission notes one of CG's recommendations that the tax refund must be refunded to customers to remedy the harm to customers.[50]

111. The Commission accepts the evidence presented by Mr. Bowman, that:

> …it would have been both imprudent and unreasonable for ATCO to base any forecast of future taxes on the assumption that it would be successful in deducting such expenses currently until it received confirmation by the CRA.

112. Based on UCA-AG-153 the Commission finds that AG became aware of the potential for additional income tax deductions after the record closed with respect to the 2005-2007 GRA. No parties have placed any evidence on the record to refute this timing.

113. Regarding the position of CG that the AG Recovery should be returned to customers, the Commission notes that customers' rates have been finalized for the years to which the refund relates based on the forecast amounts for income tax expense previously approved.

114. The Commission considers that it cannot direct that the AG Recovery be allocated to customers as it would offend the principle against retroactive ratemaking, would not support the principle of prospectivity and would undermine the principle of regulatory certainty.

115. The Commission notes that ATCO has availed itself of a permitted tax deduction. While prospective regulation employs forward looking test years to determine revenue requirement, the income tax component, which is governed by both the Federal and Provincial Income Tax acts, allows for reassessments of income tax returns filed by a utility to be made four years from the date of an original assessment notice. This mismatch between the forward-looking test year and the retrospective nature of tax adjustments is further exacerbated by the fact that waivers can be filed with the CRA to allow for reassessments beyond the four-year period. The Commission

[49] Decision 2004-035 - Aquila Networks Canada Ltd. (ANCL) and Aquila Networks Canada (Alberta) Ltd. (ANCA), *ANCL's Sale of all of the Outstanding Shares of ANCA to Fortis Alberta Holdings Inc. (Fortis Alberta);* Fortis Alberta and ANCA, *Financing the Acquisition of the ANCA Shares* (Released: April 29, 2004), page 12.

[50] Exhibit 287.01, CG Reply Argument, paragraph 67.

considers that the result of this mismatch is a significant incentive for the utility under existing tax rules to seek out additional tax deductions outside of a test year.

116. Notwithstanding this incentive, the Commission finds that AGPL has followed established precedent with respect to obtaining reassessments of income tax expenses of prior years. On this basis, the Commission concludes that AG should be allowed to keep the AG Recovery.

117. Notwithstanding that the Commission has considered that AG should be allowed to keep the AG Recovery, the Commission will consider the proposal to adjust AG's rate base for the test years, to account for the capitalized costs that ended up being deducted as expenses in the year incurred for income tax purposes.

5.3 Adjustment of Rate Base for Test Years

118. The Commission has considered the views of the parties as to whether the amounts previously classified as capital, but expensed in the period should have any effect on the amounts included in the determination of AG's rate base for the test years, given the Commission finding that AG is allowed to retain the AG Recovery.

119. The Commission notes Calgary's evidence that traditionally the Commission and its predecessors have not adjusted the carrying value of the rate base based upon the tax deductibility (or otherwise) of the assets in rate base ("net of tax method"). Calgary suggested that moving to this method on an item specific basis is not a preferable approach.

120. AG argued that no adjustment to rate base was needed and that the amounts in rate base had previously been approved by the Board or Commission as prudent costs. AG submitted that there was no evidence to suggest that any of this property was no longer required to be used, was abandoned, or that its values have been impaired. Adjusting opening rate base balances would be a confiscation of a utility's asset. Further, AG submitted that it would be inappropriate to have the income tax treatment of costs be identical to regulatory treatment.

121. AG also stated that the principles of retroactive rate making, prospectivity, regulatory certainty, and doing indirectly that which cannot be done directly, did not allow adjustment to the opening rate base balances for the test years. Further such an adjustment would be inconsistent with section 37(1) of the *Gas Utilities Act* to reduce the rate base to reflect the tax refunds.

122. Given the absence of any supporting evidence on the record which demonstrates that these amounts previously classified as capital were either imprudently incurred or that their value has been impaired, the Commission finds no basis in evidence to support an adjustment to opening rate base.

5.4 Undepreciated Capital Cost Adjustment

123. Interveners submitted that AG effectively removed approximately $23.8 million[51] from its UCC balance and that this amount is a permanent loss from the UCC which would have been

[51] Exhibit 283.01, CG Argument, page. 19, paragraph 54; CG estimated the reduction of UCC balances to be $23.8 million.

available to offset future income taxes that will be paid by customers. The Commission notes interveners requested that the UCC balances be restored to offset this permanent loss.

124. The Commission considers the restoration of UCC balances put forward by Calgary, UCA and CG to be an indirect means to facilitate the AG Recovery being given to customers and therefore this approach must be rejected by the Commission. The Commission cannot circumvent the principle against retroactive ratemaking, the prospectivity principle and the principle of regulatory certainty through an alternative technique/mechanism employed to reallocate the AG Recovery. The Commission considers that adjusting the UCC balances for regulatory purposes would be adjusting future rates (through higher CCA) for the sole purpose of recovering the relevant income tax deduction amounts for the customers' benefit.

125. Interveners took the position that restating the UCC balances was necessary to address the harm that had resulted as a consequence of AG's action and that this was a matter of future, not retroactive, ratemaking. In support of its argument, the UCA identified the "no harm" test established by the Board. A description of this test can be found in Decision 2003-098.[52]

126. In response to this position, AG argued that there was no harm caused by this action and further, if there was, that the "no harm" test had limited application.

127. AG uses the flow-through method for calculating income tax expense for the test years, which mandates that AG should calculate the lowest amount of income tax based on existing laws or laws expected to be enacted in respect of its forecast of income. In this regard the Commission recognizes that the likelihood of forecasts of income tax for any test year being identical to actual income taxes paid to income tax authorities for that year is remote. On the prospective basis for ratemaking the Commission thus accepts that customers, in rates, will be charged more or less than the actual income taxes incurred by the utility for the test year. Ordinarily, these variances were not of material consequence and have not previously raised significant concerns by any party.

128. AG acknowledged that it was aware of both of the *Canderel* and *Rainbow* income tax cases. These cases have significant implications with respect to the deductibility of certain types of expenditures which would otherwise be capitalized (and deducted as expenses over a period of years) instead of being deducted in the year incurred. Had the expenditures been required to be capitalized for income tax purposes they generally would have been included in Class 1 for UCC, which provides for a CCA rate of 4 percent.

129. In rebuttal evidence, AG calculated a total benefit to customers over the period 2008 to 2017 of $22.6 million for additional tax deductions related to AGPL's efforts to obtain tax recoveries for the capitalized direct costs for 2005 and prior years.[53] In view of the comments made by Mr. Bowman concerning the uncertainty of forecasting deductions in a year for income tax purposes of amounts capitalized for accounting purposes the Commission is unsure of the weight it can accord to AG's calculation of the benefits.

[52] Decision 2003-098 - ATCO Electric Ltd., ATCO Gas North and ATCO Gas South, Both Operating Divisions of ATCO Gas and Pipelines Ltd., Transfer of Certain Retail Assets to Direct Energy Marketing Limited and Proposed Arrangements with Direct Energy Regulated Services to Perform Certain Regulated Retail Functions, (Application No. 1299855) (Released: December 4, 3003), page 4.

[53] Exhibit 143.01, AG Rebuttal Evidence, page 133.

130. With respect to the reduction of the UCC balances, the Commission considers that ratepayers may have lost some benefit as a consequence of the Reassessments. Notwithstanding this finding, the Commission has also considered whether the "no harm" test applies in this case or could be used to circumvent the principle against retroactive ratemaking, the principle of prospectivity and the principle of regulatory certainty. The Commission considers that the application of the "no harm" test both by itself and the Board, has been limited to proceedings involving the disposition of a utility's assets outside of the normal course of business, share acquisitions, restructurings, and financings.[54] Based on the record of this proceeding, the Commission finds that if the "no harm" test were allowed a more broadly based application, the applicability of the "no harm" standard could effectively allow the regulator to rely on it as a mechanism to circumvent the principles of prospectivity and retroactive ratemaking. Further, as noted in paragraph 106 above, there are no facts on the record that would support a conclusion that AG deliberately acted to take potential income tax deductions to cause a loss of income tax benefits to customers. In the result, the Commission has decided that it will not circumvent the principle against retroactive ratemaking, the prospectivity principle and the principle of regulatory certainty through the broad application of the "no harm" test.

131. For all of the above reasons, the Commission denies the interveners' request that the AG Recovery should be either directly or indirectly returned to customers. The Commission considers that the placeholder amounts for income tax expense for 2008 and 2009 as established in Decision 2008-113 are now final.

5.5 Direction

132. As identified by the Commission, in paragraph 115, the differences between regulatory practice and income tax practice have created an incentive for the utility to maximize deductions after the close of record for a test year to the benefit of utility shareholders.

133. In Decision 2008-113, the Commission posed the following question:

> 7. Is the treatment of these income tax deductions by the other ATCO regulated utilities relevant and, if so, how? Also, given the use of deferral accounts for income taxes by AE and AP, for consistency should AG be directed to establish a deferral account?[55]

In response, both CG and Calgary recommended implementation of a deferral account for income taxes for AG.

134. The Commission considers that for the 2008-2009 test years and thereafter, a deferral account should be created for ATCO to capture all costs which may be capitalized for accounting purposes but deducted in the year incurred as an expense for income tax purposes (Income Tax Deductible Capital Cost Deferral Account).

135. The Commission directs ATCO to establish, effective January 1, 2008, an Income Tax Deductible Capital Cost Deferral Account to reconcile any variances that may arise in respect of income tax expense forecast for a test year with income taxes subsequently assessed or reassessed, as the case may be, for that same year by income tax authorities in respect of capitalized additions to rate base forecast by AG. AG is directed to provide a breakdown of the types and amounts of deductions that are being included in this deferral account as part of all

[54] See for example Decision 2003-098, Decision 2005-112, Decision 2007-094, Decision 2008-079.
[55] Decision 2008-113, page 102.

future regulatory applications. The Commission considers that the use of the Income Tax Deductible Capital Cost Deferral Account will allow AG to continue to pursue income tax deductions for use with the flow through income tax method and mitigate the risk that the CRA might disallow these deductions.

136. The Commission notes that in Decision 2008-113, it deferred consideration of the issues raised by CG with respect to capitalized expenses deducted in a year for income tax purposes. The Commission considers that the establishment of the above deferral account effectively covers the issues raised by CG.

Future Process

137. The Commission intends to initiate a proceeding which will address consistent income tax methodologies for all utilities. The Commission is also considering initiating a separate consultation process to review the regulatory framework for rate regulation in Alberta, including the use of deferral accounts, how incentives for utilities may be affected, and the resulting impacts on utilities and customers.

6 ORDER

138. IT IS HEREBY ORDERED THAT:

ATCO Gas establish an Income Tax Deductible Capital Cost Deferral Account for purposes described in this Decision, effective January 1, 2008.

Dated in Calgary, Alberta on November 12, 2009.

ALBERTA UTILITIES COMMISSION

(original signed by)

Willie Grieve
Chair

(original signed by)

N. Allen Maydonik, Q.C.
Commissioner

(original signed by)

Bill Lyttle
Commissioner

APPENDIX 1 – PROCEEDING PARTICIPANTS

Name of Organization (Abbreviation) Counsel or Representative (APPLICANTS)
ATCO Gas (AG) L. Smith
The City of Calgary (Calgary) D. Evanchuk
Consumer Group (CG) Represents: Consumers' Coalition of Alberta (CCA) J. Wachowich Public Institutional Consumers of Alberta (PICA) N. McKenzie Alberta Sugar Beet Growers Association and Potato Growers of Alberta (ASBGA/PGA) H. Unryn
Office of the Utilities Consumer Advocate (UCA) J.A. Bryan, Q.C.

Alberta Utilities Commission
Commission Panel W. Grieve, Chair N. A. Maydonik, Q.C., Commissioner B. Lyttle, Commissioner Commission Staff G. Bentivegna (Commission Counsel) V. Slawinski (Commission Counsel) B. McNulty (Commission Counsel) C. Burt D. Weir R. Armstrong D. Cherniwchan K. Schultz